



the future looks
cool



If there's one thing
we've learned in the last
ten years, it's the way to
prepare for the next ten.
With innovative new products and
services that are, for lack of a better word, **cool.**

take a *good* look
at where we're headed

1997. We witnessed an impressive widening of gross profit margins which benefited from improved manufacturing efficiencies, greater fixed asset utilization, and increased sales volume. Gross Profit grew from \$13.1 million (16.0%) in 1997 to \$19.8 million (18.5%) in 1998, a gain of 51%. Operating margins benefited from tight controls over variable costs resulting in Income from Operations rising 88% to \$9.2 million from \$4.9 million in 1997. The most important measure of performance, Net Income, climbed 73% to a record high of \$5.2 million or \$0.82 per share from \$3.0 million or \$0.48 per share.

The tight labor market we witnessed in 1997 continued in 1998 and is with us in 1999. To combat these labor constraints while minimizing price changes we have taken action in two areas. First, we have focused upon productivity enhancing investments. With labor costs increasing at a rate greater than

raw materials, labor efficiency is critical to our progress. Over the past two years we have spent \$13.8 million on capital expenditures, with the majority being for automated machinery used in our sheet metal fabricating area. This has resulted in a 150% improvement in productivity in this sector. The improvement will continue as a third \$2.5 million automated machine is presently being installed and will be operational in May. Second, we have initiated discretionary contributions to our 401(k) retirement plan in excess of funds given for matching purposes. These contributions have been made equally to all employees with more than one year of service and we have noted an increased loyalty from employees as their stake in the Company increases. Purchases of AAON common stock in the open market have been made by the 401(k) plan and are subject to vesting requirements over five years.

In late 1997, we purchased a 479,000 square foot facility adjacent to our Tulsa facility, more than doubling our available manufacturing and office space. We have begun to occupy a portion of this space and expect it to support increased production in 1999 and beyond. In Longview, we will expand our plant this year to allow for growth of two new products – air handling units and condensing units. Upon completion of these expansions, the Company will have the capacity to accommodate over \$200 million in gross revenues.

We believe that your company's future growth will require expanding sales of our present product line as well as the



In November 1998 AAON received patents for the Dimpled Heat Exchanger. The 'dimple' enhances the heat transfer characteristics that allow the elimination of an internal turbulator and future service problems.

introduction of new products. In the past we have developed unique technologies to benefit our customers. We currently have multiple patents on three items. AAONAIRE®, our patented energy recovery system, was introduced four years ago and has built momentum as customers confirm the energy savings possible

Right, the 811,000 square foot headquarters and manufacturing facilities in Tulsa, Oklahoma – one of many ways AAON keeps the cost down and the quality up.

Below, the 136,000 square foot facility of AAON Coil Products, Longview, Texas.



company highlights

Spring 1989

AAON purchased, renovated and moved into a 184,000 square foot plant in Tulsa, Oklahoma. Introduced a new product line of rooftop heating and air conditioning units 2-140 tons.

Summer 1989

Became a publicly traded company with the reverse acquisition of Diamond Heat Resources (now "AAON, Inc."), a Nevada corporation.

December 1990

Listed on NASDAQ Small Cap-Symbol "AAON".

December 1991

Formed AAON Coil Products, a Texas Corporation, as a subsidiary to AAON, Inc. (Nevada), and purchased coil making assets of Coils Plus.

Spring 1993

AAON Coil Products purchased, renovated and moved into a 110,000 square foot plant in Longview, Texas.

September 1993

One-for-four reverse stock split. Retired \$1,927,000 of subordinated debt.

November 1993

Listed on the NASDAQ National Market System.

January 1995

Introduced a desiccant heat recovery wheel option available on all AAON rooftop units.

March 1995

Purchase of property with 26,000 square ft. building adjacent to AAON Coil Products plant in Longview, TX. Issued a ten percent stock dividend.

September 1995

Completed expansion of the Tulsa facility to 332,000 square feet.

December 1997

Purchased 40 acres with 457,000 square foot plant and 22,000 square foot office space located across from Tulsa facility.

April 1998

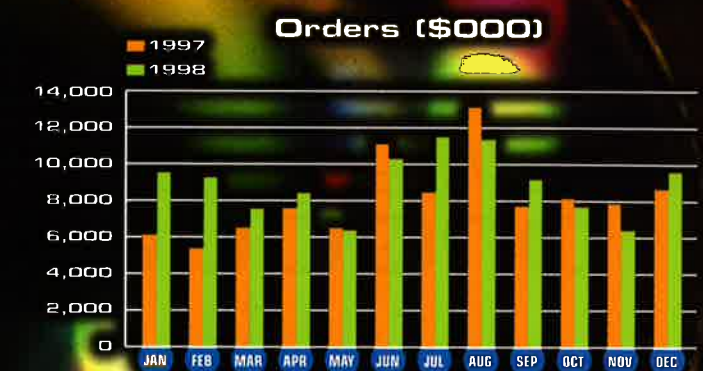
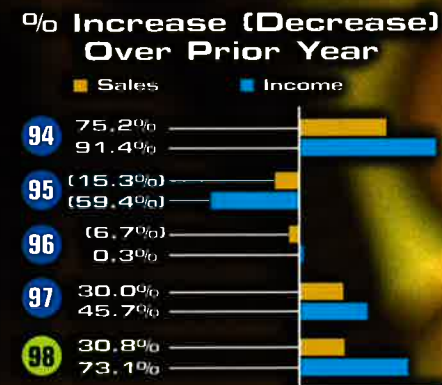
AAON receives U.S. patent for Blower Housing assembly.

October 1998

U.S. patent is granted to AAON for air conditioner with energy recovery heat wheel.

November 1998

Received U.S. patent for Dimpled Heat Exchanger Tube.



with this option. Second, our patented heat exchanger design allowed us to increase the warranted life of this component. Lastly, our patented blower assembly has incorporated a more energy efficient air-moving system into our newest version of rooftop products. These developments contribute to continuing growth of market penetration.

We are excited about new products presently in the research phase, such as a water chiller which is another large part of the commercial air conditioning market, and a redesign and expansion of our popular RF (large size) rooftop line. Changes to the RF product will expand and improve the machine's capabilities while reducing manufacturing costs through more efficient utilization of our new automated machinery.

It is important to take a moment to acknowledge the contribution made by our manufacturer's representative network to your company's growth in both sales and earnings. Over the past decade, we have built strong and trustful relationships based upon

our ability to build a quality product, at a competitive price and to deliver products on schedule. We are certainly aware that our representatives have many choices of competing products, yet in a growing number of instances the AAON product is their preferred selection. In 1998 our manufacturer's representative business grew by 31%, contributing well over 60% of our total sales. In 1999 and beyond, fortified with expanded lines of new and enhanced products, we believe representative sales will witness significant growth opportunities and continue to make important contributions to AAON's sales and earnings.

We completed 1998 in strong financial condition. Total current assets were \$32 million with current liabilities of \$15 million or a current ratio of 2.2:1. Total shareholders' equity increased to \$24.4 million or \$3.94 per share. Long-term debt stood at \$11 million and the long-term debt to equity ratio was 0.4. In 1997 our return on shareholders' equity was 19.3% and for 1998 the ROE climbed to 27.7%. Our backlog of orders at December 31, 1998 was \$31 million.

The closing of the millennium is the start of the next chapter in AAON's development. We anticipate continued growth in new markets as additional products are introduced and existing products receive expanded capabilities. We envision AAON growing in multiple markets, while undergoing continued production efficiency improvements. We remain optimistic regarding our prospects despite the cyclical nature of our industry. We are mindful that the challenges and goals before us cannot be overcome and achieved without the loyalty and support

of our customers and shareholders, and our employees listed on the inside, back-cover of this report.

For all of these we are grateful.

Sincerely,

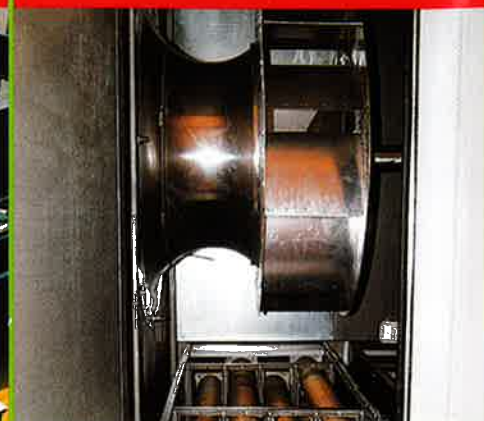
Norman H. Asbjornson
President/CEO

April 14, 1999

automated sheet metal equipment



130 ton blower and furnace



2000
AAON
the name to remember

COOL products for one hot planet.



TYPE RK
15 ton rooftop

Since the founding of AAON in 1988, we have strived to design and manufacture only the highest quality heating and cooling products that not only perform beyond all expectations, but demonstrate their value each and every day to the consumer. AAON® has now transferred its product and manufacturing knowledge to deliver many other products to the commercial HVAC marketplace. The objective remains the same: to meet the customer's specific product requirement at a reasonable first cost.



TYPE RF
130 ton rooftop



TYPE CA
25 ton condensing unit



TYPE H2-C
4000 CFM horizontal
air handler

AAON®

The Name To Remember.

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 1998

Commission file number: 33-18336-LA

AAON, INC.

(Exact name of Registrant as specified in its charter)

NEVADA
(State or other jurisdiction
of incorporation or organization)

87-0448736
(IRS Employer
Identification No.)

2425 SOUTH YUKON, TULSA, OKLAHOMA
(Address of principal executive offices)

74107
(Zip Code)

Registrant's telephone number, including area code: (918) 583-2266
Securities registered pursuant to Section 12(g) of the Act:

COMMON STOCK, PAR VALUE \$.004
(Title of Class)

RIGHTS TO PURCHASE SERIES A PREFERRED STOCK
(Title of Class)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

The aggregate market value of Registrant's voting stock held by non-affiliates computed by reference to the closing price of such stock on March 1, 1999, was approximately \$32,076,000. For purposes of this computation, all officers, directors and 5% beneficial owners of Registrant are deemed to be affiliates.

As of March 1, 1999, Registrant had outstanding a total of 6,225,449 shares of its \$.004 par value Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of Registrant's definitive Proxy Statement to be filed in connection with the Annual Meeting of Stockholders to be held May 25, 1999, are incorporated into Part III.

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Part 1

Item 1. Business.

General Development of Business AAON, Inc., a Nevada corporation ("AAON-Nevada" or, including its subsidiaries, the "Company"), was incorporated on August 18, 1987.

AAON, Inc., an Oklahoma corporation ("AAON-Oklahoma"), was incorporated on August 15, 1988, for the purpose of acquiring the assets, subject to certain liabilities, of the Heating, Ventilation and Air-Conditioning ("HVAC") Division of John Zink Company in Tulsa, Oklahoma. On June 16, 1989, pursuant to a Conversion/Exchange Agreement, AAON-Oklahoma became a wholly-owned subsidiary of AAON-Nevada.

AAON-Oklahoma is engaged in the manufacture and sale of commercial rooftop air-conditioners and heating equipment.

On December 30, 1991, AAON Coil Products, Inc. ("ACP", formerly CP/AAON, Inc.), a Texas corporation organized as a wholly-owned subsidiary of AAON-Nevada for such purpose, purchased most of the assets of Coils Plus, Inc., of Longview, Texas, which manufactures coils used in the products of AAON-Oklahoma.

Products and Markets The Company engineers, manufactures and markets commercial rooftop air-conditioning, heating and heat recovery equipment and air-conditioning coils. Its products serve the commercial and industrial new construction and replacement markets. While to date virtually all of the Company's sales have been to the domestic market, concerted efforts began in 1993 to develop foreign sales which accounted for approximately 2% of its sales last year and are projected to increase in coming years.

The rooftop market consists of units installed on commercial or industrial structures of generally less than 10 stories in height.

ACP's coil sales are made to air-conditioning unit manufacturers, including AAON-Oklahoma, and to the commercial/industrial general building market.

The size of these markets is determined primarily by the number of commercial and industrial building completions. The replacement market consists of products installed to replace existing units/components which are worn or damaged. Historically, approximately half of the industry's market has consisted of replacement units.

The commercial and industrial new construction market is subject to cyclical fluctuations in that it is generally tied to housing starts, but has a lag factor of 6-18 months. Housing starts, in turn, are affected by such factors as interest rates, the state of the economy, population growth and the relative age of the population. When new construction is down, the Company emphasizes the replacement market.

Based on its 1998 level of sales, approximately \$107 million, the Company has a 10% share of the rooftop market and a 1% share of the coil market. Approximately 65% of the Company's sales now come from new construction and 35% from renovation/replacements. The percentage of sales (for new construction vs. replacement) to particular customers is related to their stage of development, e.g., Target and Wal-Mart, 80% new construction and 20% replacement.

The Company purchases certain components, fabricates sheet metal and tubing and then assembles and tests its finished products. The finished products of AAON-Oklahoma consist of a single unit system containing heating, cooling and/or heat recovery components in a self-contained cabinet, referred to in the industry as "unitary" products. The finished products of ACP are coils, consisting of a sheet metal casing with tubing and fins contained therein.

The Company now has three groups of rooftop products: its RK Series, which is offered in 18 cooling sizes ranging from 3 to 60 tons; its RF Series, which is offered in nine cooling sizes ranging from 40 to 130 tons; and its HA Series, which is a horizontal discharge package for either rooftop or ground installation, offered in nine sizes ranging from 4 to 50 tons.

AAON-Oklahoma's engineers have developed a heat recovery wheel for its RK and RF units. The product responds to requirements of the U.S. Clean Air Act which mandate increased fresh air in commercial structures. This product, which is marketed under the name AAONAIRE®, increases the capacity of AAON HVAC units by up to 50% with no additional energy cost. The Company has been issued a patent on the adaptation of this product to its units. This enhancement was introduced in January 1995. The energy savings and comfort improvement afforded by the heat recovery wheel have been proven by numerous installations during the past year, but sales to date, while increasing, account for a minor part of revenues.

AAON-Oklahoma's products are designed to compete on the high side of standardized, packaged rooftop products. Accordingly, its prices range from \$300 to \$550 per ton of cooling, which is approximately 5%, on average, higher than other standardized products. Performance characteristics of these products range in cooling capacity from 32,900-1,563,469 BTU's and in heating capacity from 69,000-1,680,000 BTU's. All of the Company's rooftop products meet the Department of Energy's efficiency standards, which are designed to set the maximum amount of energy to be used in producing a given amount of cooling.

A typical commercial building installation requires a ton of air-conditioning for every 300-400 square feet or, for a 100,000 square foot building, 250 tons of air-conditioning, which would involve multiple units.

In 1998, ACP introduced additional products, consisting of air handling units and condensing units. While the Company anticipates sales of these products to become significant in future years, sales to date have been modest.

Major Customers The Company's largest customers last year were Wal-Mart Stores, Inc., Home Depot, Inc., and Target Stores, Inc. Sales to Wal-Mart, Home Depot and Target were 21%, 8% and 7% of total sales, respectively, in 1998 compared to 11%, 6% and 11%, respectively, in 1997. The Company has no written contract with these customers.

The loss of any of the above customers would have a material adverse effect on the Company. However, with the continuing expansion of the Company's customer base, management believes that the extent of its dependence on sales to its major customers will diminish over a period of time.

In order to diversify its customer base, the Company has added to and/or upgraded its sales representation in various markets.

Sources and Availability of Raw Materials The most important materials purchased by the Company are steel, copper and aluminum, which are obtained from domestic suppliers. The Company also purchases from other domestic manufacturers certain components, including compressors, electric motors and electrical controls used in its products. The Company endeavors to obtain the lowest possible cost in its purchases of raw materials and components, consistent with meeting specified quality standards. The Company is not dependent upon any one source for its raw material or the major components of its manufactured products, but AAON-Oklahoma purchases all of its coils from ACP. By having multiple suppliers, the Company believes that it will have adequate sources of supplies to meet its manufacturing requirements for the foreseeable future.

Further, the Company attempts to limit the impact of increases in raw materials and purchased component prices on its profit margins by negotiating with each of its major suppliers on a term basis from six months to three years.

Distribution The Company utilizes a direct sales staff of nine individuals and approximately 83 independent manufacturer representatives' organizations having 104 offices to market its products in the United States. The Company also has one international sales organization, which utilizes 10 distributors in other countries. Sales are made directly to the contractor or end user, with shipments being made from the Company's Tulsa and Longview plants to the job site. Billings are to the contractor or end user, with a commission paid directly to the manufacturer representative.

AAON-Oklahoma's products and sales strategy focus on a "niche" market. The targeted market for its rooftop equipment is customers seeking a product of better quality than offered, and/or options not offered, by standardized manufacturers.

To support and service its customers and the ultimate consumer, AAON-Oklahoma provides parts availability through three independent parts distributors and has a factory service organization at its Tulsa plant. Also, a number of the manufacturer representatives utilized by the Company have their own service organizations, which, together with the Company, provide the necessary warranty work and/or normal service to customers.

The Company's warranty on its products is: for parts only, the earlier of one year from the date of first use or 15 months from date of shipment; compressors, an additional four years; and on gas-fired heat exchangers (if applicable), 10 years.

Research and Development All R&D activities of the Company are company-sponsored, rather than customer-sponsored. Ongoing work involves the HA Series, component evaluation and refinement, development of control systems and new product development. This work will cost approximately \$200,000 per year and is budgeted as a normal, recurring expense.

Backlog The Company had a current backlog as of March 1, 1999, of \$29,833,000, compared to \$37,482,000 at March 1, 1998. The current backlog consists of orders considered by management to be firm and substantially all of which will be filled by August 1, 1999; however, the orders are subject to cancellation by the customers.

Working Capital Practices Working capital practices in the industry center on inventories and accounts receivable. The Company regularly reviews its working capital components with a view to maintaining the lowest level consistent with requirements of anticipated levels of operation. Its greatest needs arise during the months of July-November, the peak season for inventory (primarily purchased material) and accounts receivable. The Company's working capital requirements are generally met through a bank revolving credit facility, which currently permits borrowings up to \$15,150,000. The Company believes that it will have sufficient bank credit available to meet its working capital needs through 1999 and beyond.

Seasonality Sales of the Company's products are moderately seasonal with the peak period being July-November of each year.

Competition In the domestic market, the Company competes primarily with Trane Company, a division of American Standard, Inc., Carrier Corporation, a subsidiary of United Technologies Corporation, Lennox Industries, Inc., and York International Corporation. All of these competitors are substantially larger and have greater resources than the Company. The Company competes primarily on the basis of total value, quality, function, serviceability, efficiency, availability of product, product line recognition and acceptability of sales

outlet. However, in new construction where the contractor is the purchasing decision maker, AAON-Oklahoma often is at a competitive disadvantage on sales of rooftop units because of the emphasis placed on initial cost; whereas, in the replacement market and other owner-controlled purchases of such units, the Company has a better chance of getting the business since quality and long-term cost are generally taken into account.

Employees As of March 1, 1999, the Company had 872 employees and 99 temporaries, none of whom are represented by unions. Management considers its relations with its employees to be good.

Patents, Trademarks, Licenses and Concessions The Company does not consider any patents, trademarks, licenses or concessions held by it to be material to its business operations, other than possibly the patent issued regarding the heat recovery wheel option known as AAONAIR® discussed under "Products and Markets".

Environmental Matters Laws concerning the environment that affect or could affect the Company's domestic operations include, among others, the Clean Water Act, the Clean Air Act, the Resource Conservation and Recovery Act, the Occupational Safety and Health Act, the National Environmental Policy Act, the Toxic Substances Control Act, regulations promulgated under these Acts, and any other federal, state or local laws or regulations governing environmental matters. The Company believes that it presently complies with these laws and that future compliance will not materially adversely affect the Company's earnings or competitive position.

Item 2. Properties.

The plant and office facilities of AAON-Oklahoma consist of a 337,000 square foot building (322,000 sq. ft. of manufacturing/warehouse space and 15,000 sq. ft. of office space) located on a 12-acre tract of land at 2425 South Yukon, Tulsa, Oklahoma (the "original facility"), and a 457,000 square foot manufacturing/warehouse building and a 22,000 square foot office building (the "expansion facility") located on a 40-acre tract of land across the street from the original facility. Both plants are of sheet metal construction.

The original facility's manufacturing area is in a heavy industrial type building, with total coverage by bridge cranes, containing manufacturing equipment designed for sheet metal fabrication and metal stamping. The manufacturing equipment contained in the original facility consists primarily of automated sheet metal fabrication equipment, supplemented by presses, press breaks and NC punching equipment. Assembly lines consist of four cart-type conveyor lines with variable line speed adjustment, three of which are motor driven. Subassembly areas and production line manning are based upon line speed. The manufacturing facility is 1,140 feet in length and varies in width from 390 feet to 220 feet. Production at this facility averaged approximately \$8.6 million per month in 1998, which is 52% of the estimated capacity of the plant. Management deems this plant to be nearly ideal for the type of rooftop products being manufactured by the Company.

The expansion facility, which was purchased on December 31, 1997, is 24% (108,000 sq. ft.) utilized by the Company and 76% leased to third parties. The Company uses 8,000 sq. ft. for office space and 20,000 sq. ft. for warehouse space and will utilize 80,000 sq. ft. for manufacturing in 1999. The remaining 349,000 sq. ft. will afford the Company additional plant and office space for long-term growth.

The operations of ACP are conducted in a plant/office building at 203-207 Gum Springs Road in Longview, Texas, containing 138,000 square feet on 14 acres. The manufacturing area (approximately 131,000 square feet) is located in two 120-foot wide sheet metal buildings connected by an adjoining structure and a 28,000 square foot building adjacent thereto. The facility is built for light industrial manufacturing.

Bank borrowings of the Company, totaling \$6,060,000 at March 1, 1999, are secured, in part, by its Longview buildings.

Item 3. Legal Proceedings.

The Company is not a party to any pending legal proceeding which management believes is likely to result in a material liability and no such action is contemplated by or, to the best of its knowledge, has been threatened against the Company.

Item 4. Submission of Matters to a Vote of Security Holders.

No matter was submitted to a vote of security holders, through solicitation of proxies or otherwise, during the period from October 1, 1998, through December 31, 1998.

Part II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters.

The Company's Common Stock is traded on the NASDAQ National Market under the symbol "AAON". The range of sales prices for the Company's Common Stock during the last two years, as reported by National Association of Securities Dealers, Inc., was as follows:

Quarter Ended	High Bid	Low Bid
March 31, 1997	\$ 7.60	\$ 4.32
June 30, 1997	\$ 8.56	\$ 5.48
September 30, 1997	\$ 8.46	\$ 7.16
December 31, 1997	\$ 9.44	\$ 6.40
March 31, 1998	\$11.75	\$ 6.63
June 30, 1998	\$11.50	\$ 9.75
September 30, 1998	\$11.00	\$ 6.75
December 31, 1998	\$10.50	\$ 7.50

On March 1, 1999, there were 195 holders of record, and 2,039 beneficial owners, of the Company's Common Stock.

Since its inception, no cash dividends have been paid on the Company's Common Stock and the Company does not anticipate paying cash dividends in the foreseeable future. There is a negative covenant under the Company's Revolving Credit and Term Loan Agreement which prohibits the declaration or payment of such dividends. The Company paid a 10% stock dividend on March 27, 1995.

Item 6. Selected Financial Data.

The following selected financial data should be read in conjunction with the financial statements and related notes thereto for the periods indicated, which are included elsewhere in this report.

Years ended December 31,					
Results of Operations:	1998	1997	1996	1995	1994
	<i>(In thousands, except earnings per share)</i>				
Net sales	\$106,781	\$ 81,676	\$ 62,845	\$ 67,346	\$79,542
Net income	\$ 5,230	\$ 3,022	\$ 2,075	\$ 2,069	\$ 5,101
Basic earnings per share	\$.84	\$.49	\$.34	\$.34	\$.84
Diluted earnings per share	\$.82	\$.48	\$.33	\$.33	\$.81

December 31,					
Balance Sheet Data:	1998	1997	1996	1995	1994
	<i>(In thousands)</i>				
Total assets	\$ 50,506	\$ 42,810	\$ 35,569	\$ 32,212	\$32,562
Long-term debt	\$ 10,980	\$ 12,857	\$ 8,976	\$ 10,695	\$10,648
Stockholders' equity	\$ 24,411	\$ 18,873	\$ 15,640	\$ 13,546	\$11,461

Basic earnings per common share were computed by dividing net income by the weighted average number of shares of common stock outstanding during the reporting period. Diluted earnings per common share were determined on the assumed exercise of dilutive options, as determined by applying the treasury stock method.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Set forth below is income statement information with respect to the Company for years 1998, 1997 and 1996:

	Years ended December 31,		
	1998	1997	1996
	<i>(In thousands)</i>		
Net sales	\$106,781	\$ 81,676	\$ 62,845
Cost of sales	86,952	68,605	51,797
Gross profit	19,829	13,071	11,048
Selling, general and administrative expenses	10,626	8,146	6,413
Income from operations	9,203	4,925	4,635
Interest expense	1,017	687	838
Other (income) expense	(359)	167	406
Income before income taxes	8,545	4,071	3,391
Income tax provision	3,315	1,049	1,316
Net income	<u>\$ 5,230</u>	<u>\$ 3,022</u>	<u>\$ 2,075</u>

Results of Operations Net sales increased approximately 31% in 1998 as compared to 1997, and 1997 sales were 30% greater than in 1996. The increase in sales in 1998 and 1997 were attributable to increased sales to the Company's entire customer base, which is expected to continue in 1999.

Gross profit increased in 1998 to 18.6% compared to 16.0% in 1997, and 17.6% in 1996. The increase in margins in 1998 was attributable to the addition of automated sheet metal equipment, the elimination of outsourcing of sheet metal production and a slight improvement in labor shortage.

While SG&A expenses increased by 30% in 1998 compared to 1997, these expenses remained relatively the same in 1998, 1997 and 1996 as a percent of sales.

Interest expense was higher in 1998 compared to 1997 and 1996 due to increased capital expenditures and greater sales and accounts receivable. Borrowings in all three years were minimized by profits and effective control of inventories.

The \$359,000 of other income in 1998, compared to other expenses in 1997 and 1996, is primarily attributable to rental income from the Company's "expansion facility" (see Item 2).

Income before income taxes in 1996-1998 were relatively the same as a percent of sales.

The income tax provisions in 1998 and 1997 were affected by permanent tax deductions and credits.

Financial Condition and Liquidity Accounts receivable increased by \$3,915,000 and inventories increased by \$1,508,000 at December 31, 1998, compared to year end 1997, due to the increase in sales during 1998.

Property, Plant and Equipment at December 31, 1998, was approximately \$2 million higher than at year end 1997 due to equipment purchases, in excess of depreciation. All capital expenditures in 1998 were financed out of cash flow, borrowings under the Company's revolving credit bank loan and equipment financing.

The size of accounts payable at December 31, 1998 and 1997 primarily reflect the inventories and sales volumes in each of those years and the timing of payments to creditors.

Also, accrued liabilities at year-end 1998 and 1997 reflect the amount of reserves (warranty and commissions) related to sales and the timing of estimated income tax payments.

The capital needs of the Company are met primarily by its bank revolving credit facility. Management believes this bank debt (or comparable financing), term loans and projected profits from operations will provide the necessary liquidity and capital resources to the Company for at least the next five years. The Company's belief that it will have the necessary liquidity and capital resources is based upon its knowledge of the HVAC industry and its place in that industry, its ability to limit the growth of its business if necessary, and its relationship with its existing bank lender.

The Company's revolving credit line (which currently extends to August 31, 2000) provides for maximum borrowings of \$15,150,000. Interest on this line is payable monthly at the Wall Street Journal prime rate less .5% or LIBOR plus 1.7%, at the election of the Company. This loan is collateralized by the accounts receivable, inventory and general intangibles of the Company's two operating subsidiaries.

Year 2000 Disclosure ("Y2K") The Company believes that it is now fully compliant in regard to the "Year 2000 Problem", insofar as its internal operations are concerned, except for embedded technology in two major sheet metal fabricating machines which are scheduled to be corrected by June 30, 1999. With regard to its suppliers, in September, 1998, the Company sent 800 questionnaires to determine their state of readiness and the readiness of the suppliers' suppliers. To date approximately 350 responses have been received, most indicating that they are in compliance. The Company is following up with those not in compliance and those who have not responded. On or before the start of the fourth quarter of 1999, the Company will be doing business only with suppliers who are in compliance.

The Company does not anticipate incurring material costs in addressing Y2K issues.

Subject to timely correction of the embedded technology in the sheet metal fabricating machines mentioned above, the Company does not believe it will experience any material adverse consequences to its manufacturing operations, internally or externally, due to Y2K, but management can conceive of problems in receiving payments from customers if there should be wide-spread defects affecting the financial/banking industry.

If the Company has any concerns as to specific suppliers, it would commence a buildup of inventory of such parts starting in the third quarter of 1999 and establish alternate suppliers for those in question.

Forward-Looking Statements This Annual Report includes "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Words such as "expects", "anticipates", "intends", "plans", "believes", "seeks", "estimates", "will", variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions which are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date on which they are made. The Company undertakes no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise. Important factors that could cause actual results to differ materially from those in the forward-looking statements include (1) the timing and extent of changes in material prices, (2) the effects of fluctuations in the commercial/industrial new construction market, (3) the timing and extent of changes in interest rates, as well as other competitive factors during the year, and (4) general economic, market or business conditions.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

While the Company is exposed to changes in interest rates regarding \$9,970,000 of its total debt of \$11,737,000, a hypothetical 10% change in interest rates on its variable rate borrowings would not have a material effect on the Company's earnings or cash flow.

Foreign sales accounted for only 2% of the Company's sales in 1998 and the Company accepts payment for such sales only in U.S. dollars; hence, the Company is not exposed to any foreign currency exchange rate risk.

Important raw materials purchased by the Company are steel, copper and aluminum, which are subject to price fluctuations. The Company attempts to limit the impact of price increases on these materials by negotiating with each of its major suppliers on a term basis from six months to three years.

Item 8. Financial Statements and Supplementary Data.

The financial statements and supplementary data are included at page 14.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

Part III

Item 10. Directors and Executive Officers of Registrant.

Incorporated by reference to the Company's definitive Proxy Statement to be filed with the Securities and Exchange Commission in connection with the Company's 1999 Annual Meeting of Stockholders.

Item 11. Executive Compensation.

Incorporated by reference to the Company's definitive Proxy Statement to be filed with the Securities and Exchange Commission in connection with the Company's 1999 Annual Meeting of Stockholders.

Item 12. Security Ownership of Certain Beneficial Owners and Management.

Incorporated by reference to the Company's definitive Proxy Statement to be filed with the Securities and Exchange Commission in connection with the Company's 1999 Annual Meeting of Stockholders.

Item 13. Certain Relationships and Related Transactions.

Incorporated by reference to the Company's definitive Proxy Statement to be filed with the Securities and Exchange Commission in connection with the Company's 1999 Annual Meeting of Stockholders.

Part IV

Item 14. Exhibits, Financial Statement Schedules and Reports on Form 8-K.

(a) 1. **Financial statements.**

See Index to Consolidated Financial Statements on page 13.

2. **Exhibits:**

- (3) (A) Articles of Incorporation (i)
- (A-1) Article Amendments (ii)
- (B) Bylaws (i)
- (B-1) Amendments of Bylaws (iii)
- (4) (A) Second Restated Revolving Credit and Term Loan Agreement ("Loan Agreement") and related documents (iv)
- (A-1) Latest amendments of Loan Agreement (v)
- (B) Rights Agreement dated February 19, 1999 (vi)
- (10) AAON, Inc. 1992 Stock Option Plan, as amended (vii)
- (21) List of Subsidiaries (viii)
- (27) Financial Data Schedule

- (i) Incorporated herein by reference to the exhibits to the Company's Form S-18 Registration Statement No. 33-18336-LA.
- (ii) Incorporated herein by reference to the exhibits to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1990, and to the Company's Forms 8-K dated March 21, 1994, and March 10, 1997.
- (iii) Incorporated herein by reference to the Company's Forms 8-K dated March 10, 1997, May 27, 1998 and February 25, 1999, or exhibits thereto.
- (iv) Incorporated by reference to exhibit to the Company's Form 8-K dated September 25, 1996.
- (v) Incorporated herein by reference to exhibits to the Company's Forms 8-K dated September 26, 1997, and March 5, 1999.
- (vi) Incorporated by reference to exhibits to the Company's Form 8-K dated February 25, 1999, and Form 8-A Registration Statement No. 000-18953.
- (vii) Incorporated herein by reference to exhibits to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1991, and to the Company's Form S-8 Registration Statement No. 33-78520, as amended.
- (viii) Incorporated herein by reference to exhibit to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1991.

- (b) The Company did not file any reports on Form 8-K during the period from October 1, 1998, to December 31, 1998.

Signatures

Pursuant to the requirement of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned, hereunto duly authorized.

AAON, INC.

Dated: March 22, 1999

By: /s/ Norman H. Asbjornson
Norman H. Asbjornson, President

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Dated: March 22, 1999

 /s/ Norman H. Asbjornson
Norman H. Asbjornson
President and Director
(principal executive officer)

Dated: March 22, 1999

 /s/ William A. Bowen
William A. Bowen
Vice President-Finance and Director
(principal financial officer and principal accounting officer)

Dated: March 22, 1999

 /s/ John B. Johnson, Jr.
John B. Johnson, Jr.
Director

Dated: March 22, 1999

 /s/ Joseph M. Klein
Joseph M. Klein
Director

Index to Consolidated Financial Statements

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Report of Independent Public Accountants

To the Stockholders of AAON, Inc.:

We have audited the accompanying consolidated balance sheets of AAON, Inc. (a Nevada corporation) and subsidiaries as of December 31, 1998 and 1997, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of AAON, Inc. and subsidiaries as of December 31, 1998 and 1997, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles.

ARTHUR ANDERSEN LLP

Tulsa, Oklahoma
February 5, 1999

Consolidated Balance Sheets

(In thousands, except share amounts)

December 31,

ASSETS	1998	1997
CURRENT ASSETS:		
Cash	\$ 25	\$ 26
Accounts receivable, net	17,933	14,018
Inventories, net	12,160	10,652
Prepaid expenses and other	241	445
Deferred income taxes	1,594	1,084
Total current assets	<u>31,953</u>	<u>26,225</u>
PROPERTY, PLANT AND EQUIPMENT, net		
	18,553	16,585
Total assets	<u>\$ 50,506</u>	<u>\$ 42,810</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 8,478	\$ 7,137
Accrued liabilities	5,597	3,727
Current maturities of long-term debt	757	175
Total current liabilities	<u>14,832</u>	<u>11,039</u>
DEFERRED TAX LIABILITY	283	41
LONG-TERM DEBT	10,980	12,857
STOCKHOLDERS' EQUITY, per accompanying statements:		
Preferred stock, \$.001 par value, 5,000,000 shares authorized, no shares issued	-	-
Common stock, \$.004 par value, 50,000,000 shares authorized, 6,219,449 and 6,176,449 issued at December 31, 1998 and 1997, respectively	25	25
Additional paid-in capital	8,224	7,916
Retained earnings	16,162	10,932
Total stockholders' equity	<u>24,411</u>	<u>18,873</u>
Total liabilities and stockholders' equity	<u>\$ 50,506</u>	<u>\$ 42,810</u>

The accompanying notes are an integral part of these consolidated balance sheets.

Consolidated Statements of Operations

(In thousands, except per share amounts)

	Years Ended December 31,		
	1998	1997	1996
NET SALES	\$ 106,781	\$ 81,676	\$ 62,845
COST OF SALES	86,952	68,605	51,797
GROSS PROFIT	19,829	13,071	11,048
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	10,626	8,146	6,413
INCOME FROM OPERATIONS	9,203	4,925	4,635
INTEREST EXPENSE	1,017	687	838
OTHER (INCOME) EXPENSE	(359)	167	406
INCOME BEFORE INCOME TAXES	8,545	4,071	3,391
INCOME TAX PROVISION	3,315	1,049	1,316
NET INCOME	\$ 5,230	\$ 3,022	\$ 2,075
EARNINGS PER SHARE:			
Basic	\$.84	\$.49	\$.34
Diluted	\$.82	\$.48	\$.33
WEIGHTED AVERAGE SHARES OUTSTANDING:			
Basic	6,202,035	6,159,177	6,118,697
Diluted	6,385,328	6,303,426	6,301,560

The accompanying notes are an integral part of these consolidated statements.

Consolidated Statements of Stockholders' Equity

(In thousands)

	Common Stock Shares	Common Stock Amount	Paid-in Capital	Retained Earnings	Total
BALANCE, JANUARY 1, 1996	6,113	\$24	\$ 7,687	\$ 5,835	\$13,546
NET INCOME	-	-	-	2,075	2,075
STOCK OPTIONS EXERCISED	15	1	18	-	19
BALANCE, DECEMBER 31, 1996	6,128	25	7,705	7,910	15,640
NET INCOME	-	-	-	3,022	3,022
STOCK OPTIONS EXERCISED	48	-	211	-	211
BALANCE, DECEMBER 31, 1997	6,176	25	7,916	10,932	18,873
NET INCOME	-	-	-	5,230	5,230
STOCK OPTIONS EXERCISED	43	-	308	-	308
BALANCE, DECEMBER 31, 1998	6,219	\$25	\$ 8,224	\$16,162	\$24,411

The accompanying notes are an integral part of these consolidated statements.

Consolidated Statements of Cash Flows

(In thousands)

	Years Ended December 31,		
	1998	1997	1996
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	\$ 5,230	\$ 3,022	\$ 2,075
Adjustments to reconcile net income to net cash provided by operating activities-			
Depreciation and amortization	2,848	2,517	2,497
Provision for losses on accounts receivable	324	175	450
Provision for excess and obsolete inventories	200	20	-
Gain on disposition of assets	(48)	(13)	-
Deferred income taxes	(269)	1,370	(860)
Change in assets and liabilities-			
Accounts receivable	(4,239)	(654)	(4,143)
Inventories	(1,708)	(1,532)	(59)
Prepaid expenses and other	204	(239)	286
Accounts payable	1,341	1,040	1,673
Accrued liabilities	1,926	(934)	2,160
Net cash provided by operating activities	5,809	4,772	4,079
CASH FLOWS FROM INVESTING ACTIVITIES:			
Proceeds from sale of property, plant and equipment	70	81	-
Capital expenditures	(4,837)	(9,037)	(2,053)
Net cash used in investing activities	(4,767)	(8,956)	(2,053)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Borrowings under revolving credit agreement	50,239	39,910	32,651
Payments under revolving credit agreement	(54,835)	(37,115)	(31,899)
Proceeds from long-term debt	3,756	1,260	-
Payments on long-term debt	(455)	(90)	(3,322)
Stock options exercised	252	107	19
Net cash provided by (used in) financing activities	(1,043)	4,072	(2,551)
NET DECREASE IN CASH	(1)	(112)	(525)
CASH, beginning of year	26	138	663
CASH, end of year	\$ 25	\$ 26	\$ 138

The accompanying notes are an integral part of these consolidated statements.

Notes to Consolidated Financial Statements

December 31, 1998 and 1997

(Dollar amounts in thousands, except share and per share information)

1. BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

AAON, Inc. (the Company, a Nevada corporation) is engaged in the manufacture and sale of commercial rooftop air conditioners, heating equipment and air conditioning coils through its wholly-owned subsidiaries AAON, Inc. (AAON, an Oklahoma corporation) and AAON Coil Products, Inc. (ACP, a Texas corporation). The consolidated financial statements include the accounts of the Company and its subsidiaries, AAON and ACP. All significant intercompany accounts and transactions have been eliminated.

Revenue Recognition Revenues are recognized at the time of shipment.

Business and Credit Concentrations The Company's customers are concentrated primarily in the domestic commercial and industrial new construction and replacement markets. No single customer accounted for a significant amount of the Company's accounts receivable at December 31, 1998. The Company reviews a customer's credit history before extending credit. The Company establishes an allowance for doubtful accounts based upon factors surrounding the credit risk of specific customers, historical trends and other information.

Sales to customers with greater than 10% of total sales consist of the following:

	Years Ended December 31,		
	1998	1997	1996
Target Stores, Inc.	*	11%	14%
Wal-Mart Stores, Inc.	21%	11%	*

* Less than 10%

Inventories Inventories are valued at the lower of cost or market. Cost is determined by the first-in, first-out (FIFO) method.

Property, Plant and Equipment Property, plant and equipment are stated at cost. Maintenance, repairs and betterments, including replacement of minor items, are charged to expense; major additions to physical properties are capitalized. Property, plant and equipment are depreciated using the straight-line method over the following estimated useful lives:

	<u>Years</u>
Buildings	10-20
Machinery and equipment	3-7
Furniture and fixtures	3-5

Warranties A provision is made for the estimated cost of warranty obligations at the time the related products are sold. Warranty expense was \$3,617, \$2,356 and \$1,547 for the years ended December 31, 1998, 1997 and 1996, respectively.

Earnings Per Share The Company applies Statement of Financial Accounting Standards (SFAS) No. 128, "Earnings Per Share." Basic earnings per common share were computed by dividing net income by the weighted average number of shares of common stock outstanding during the reporting period. Diluted earnings per common share were determined on the assumed exercise of dilutive options, as determined by applying the treasury stock method. At December 31, 1998, 27,500 options were considered to be anti-dilutive. For the year ended December 31, 1997 and 1996, all outstanding options were considered diluted. A reconciliation of net income and weighted average shares used in computing basic and diluted earnings per share is as follows:

	<u>For the Year Ended December 31, 1998</u>		
	<u>Income</u>	<u>Shares</u>	<u>Per Share Amount</u>
Basic EPS			
Net income	\$ 5,230	6,202	\$.84
Options issued to employees	-	183	-
Diluted EPS			
Net income	\$ 5,230	6,385	\$.82

	<u>For the Year Ended December 31, 1997</u>		
	<u>Income</u>	<u>Shares</u>	<u>Per Share Amount</u>
Basic EPS			
Net income	\$ 3,022	6,159	\$.49
Options issued to employees	-	144	-
Diluted EPS			
Net income	\$ 3,022	6,303	\$.48

	<u>For the Year Ended December 31, 1996</u>		
	<u>Income</u>	<u>Shares</u>	<u>Per Share Amount</u>
Basic EPS			
Net income	\$ 2,075	6,119	\$.34
Options issued to employees	-	183	-
Diluted EPS			
Net income	\$ 2,075	6,302	\$.33

Reclassifications Certain reclassifications have been made to the prior years' financial statements to conform with the 1998 presentation. Such reclassifications did not impact net income.

Use of Estimates The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

New Accounting Pronouncements In June 1998, the Financial Accounting Standards Board issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 establishes accounting and reporting standards requiring that every derivative instrument (including certain derivative instruments embedded in other contracts) be recorded in the balance sheet as either an asset or liability measured at its fair value. Companies must formally document, designate, and assess the effectiveness of transactions that receive hedge accounting. SFAS No. 133 is effective for fiscal years beginning after June 15, 1999. SFAS No. 133 cannot be applied retroactively and must be applied to (a) derivative instruments and (b) certain derivative instruments embedded in hybrid contracts that were issued, acquired, or substantively modified after December 31, 1997. The Company has not yet quantified the impact of adopting SFAS No. 133 on its financial statements and has not determined the timing of or method of the adoption of SFAS No. 133. However, as of December 31, 1998, the Company had no outstanding derivative instruments.

Details to Consolidated Balance Sheets

	December 31,	
	1998	1997
ACCOUNTS RECEIVABLE:		
Accounts receivable	\$ 18,343	\$ 14,378
Less- allowance for doubtful accounts	410	360
Total, net	<u>\$ 17,933</u>	<u>\$ 14,018</u>
INVENTORIES:		
Raw materials	\$ 8,253	\$ 7,223
Work in process	1,628	2,136
Finished goods	2,629	1,443
	<u>12,510</u>	<u>10,802</u>
Less- allowance for excess and obsolete inventories	350	150
Total, net	<u>\$ 12,160</u>	<u>\$ 10,652</u>
PROPERTY, PLANT AND EQUIPMENT:		
Land	\$ 874	\$ 874
Buildings	12,089	11,865
Machinery and equipment	16,264	11,906
Furniture and fixtures	2,004	1,909
	<u>31,231</u>	<u>26,554</u>
Less- accumulated depreciation	12,678	9,969
Total, net	<u>\$ 18,553</u>	<u>\$ 16,585</u>
ACCRUED LIABILITIES:		
Warranty	\$ 2,010	\$ 1,490
Commissions	1,877	1,220
Income taxes	419	-
Other	1,291	1,017
Total	<u>\$ 5,597</u>	<u>\$ 3,727</u>

	Year Ended December 31,		
	1998	1997	1996
ALLOWANCE FOR DOUBTFUL ACCOUNTS:			
Balance, beginning of period	\$ 360	\$ 533	\$ 204
Provision for losses on accounts receivable	324	175	450
Accounts receivable written off, net of recoveries	(274)	(348)	(121)
Balance, end of period	<u>\$ 410</u>	<u>\$ 360</u>	<u>\$ 533</u>
ALLOWANCE FOR EXCESS AND OBSOLETE INVENTORY:			
Balance, beginning of period	\$ 150	\$ 130	\$ 150
Provision for excess and obsolete inventories	200	20	-
Inventories written off	-	-	(20)
Balance, end of period	<u>\$ 350</u>	<u>\$ 150</u>	<u>\$ 130</u>

2. SUPPLEMENTAL CASH FLOW INFORMATION:

Interest payments of \$1,017, \$682 and \$813 were made during the years ended December 31, 1998, 1997 and 1996, respectively. Payments for income taxes of \$2,914, \$912 and \$652 were made during the years ended December 31, 1998, 1997 and 1996, respectively.

3. DEBT:

Long-term debt at December 31, consists of the following:

	1998	1997
\$15,150 bank line of credit, with interest payable monthly at LIBOR plus 1.70% (6.64% at December 31, 1998), due August 31, 2000, collateralized by accounts receivable and inventory.	\$ 6,890	\$ 11,485
Bank note, payable in monthly installments of \$3, through March 2000, plus interest at the bank's prime rate plus 1/4% (8% at December 31, 1998), collateralized by real estate.	250	287
Notes payable, due in 84 equal monthly installments beginning in April 1998, with interest ranging from 5.6% to 7.52% at December 31, 1998, collateralized by machinery and equipment.	4,597	1,260
	<u>11,737</u>	<u>13,032</u>
Less- current maturities	757	175
	<u>\$ 10,980</u>	<u>\$ 12,857</u>

Maturities of long-term debt for each of the years ended December 31, are as follows:

1999	\$ 757
2000	7,816
2001	717
2002	717
2003	717
Thereafter	1,013
	<u>\$ 11,737</u>

The revolving credit agreement requires, among other things, that the Company maintain a minimum tangible net worth, working capital and debt to tangible net worth ratio and it limits capital expenditures. At December 31, 1998, the Company was in compliance with the covenants of the revolving credit agreement.

Based on the borrowing rates currently available to the Company for bank loans with similar terms and average maturities, the fair value of the long-term debt approximates the carrying value.

4. INCOME TAXES:

The Company accounts for income taxes as required by SFAS No. 109, "Accounting for Income Taxes." Under this method, deferred tax liabilities and assets are determined based on the difference between the financial statement and income tax basis of assets and liabilities using currently enacted tax rates.

The income tax provision consists of the following:

	<u>Year Ended December 31,</u>		
	<u>1998</u>	<u>1997</u>	<u>1996</u>
Current	\$ 3,584	\$ 622	\$ 2,176
Deferred	(269)	427	(860)
	<u>\$ 3,315</u>	<u>\$ 1,049</u>	<u>\$ 1,316</u>

The reconciliation of the federal statutory income tax rate to the effective income tax rate is as follows:

	<u>Year Ended December 31,</u>		
	<u>1998</u>	<u>1997</u>	<u>1996</u>
Federal statutory rate	34%	34%	34%
State income taxes	5	-	5
Employment credits	(1)	(4)	-
Other	1	(4)	-
	<u>39%</u>	<u>26%</u>	<u>39%</u>

The tax effect of temporary differences giving rise to the Company's deferred income taxes at December 31 are as follows:

	<u>1998</u>	<u>1997</u>
Deferred tax assets -		
Valuation reserves	\$ 552	\$ 197
Warranty accrual	764	575
Other accruals	222	291
Other, net	56	21
	<u>\$ 1,594</u>	<u>\$ 1,084</u>
Deferred tax liabilities -		
Depreciation and amortization	\$ 283	\$ 41

5. BENEFIT PLANS:

The Company maintains a stock option plan for key employees and directors and restricts 1,000,000 shares of common stock for issuance under the plan. Under the terms of this plan, the exercise price of shares granted will not be less than 85% of their fair market value at the date of the grant. The exercise price of all options granted was equal to the market price at the date of grant. Options granted vest at a rate of 20% per year, commencing one year after date of grant, and are exercisable for ten years. At December 31, 1998, 133,125 shares were available for granting future options. The number and exercise price of options granted were as follows:

	<u>Number of Shares</u>	<u>Price Per Share</u>
OUTSTANDING AT JANUARY 1, 1996	276,650	\$ 1.14-13.01
Granted	207,125	\$ 4.50-5.88
Exercised	(15,125)	\$ 1.19
Cancelled	(42,900)	\$ 13.01
OUTSTANDING AT DECEMBER 31, 1996	425,750	\$ 1.14-5.88
Granted	167,500	\$ 5.25-7.19
Exercised	(47,875)	\$ 1.14-5.13
Cancelled	(20,000)	\$ 5.13
OUTSTANDING AT DECEMBER 31, 1997	525,375	\$ 1.14-7.19
Granted	291,500	\$ 7.63-11.25
Exercised	(43,000)	\$ 1.19-7.19
Cancelled	(35,000)	\$ 7.63
OUTSTANDING AT DECEMBER 31, 1998	<u>738,875</u>	<u>\$ 1.14-11.25</u>
EXERCISABLE AT DECEMBER 31, 1998	<u>271,400</u>	<u>\$ 1.14-7.19</u>

The following is a summary of stock options outstanding as of December 31, 1998:

<u>Range of Exercise Prices</u>	<u>Options Outstanding</u>			<u>Options Exercisable</u>	
	<u>Number Outstanding at December 31, 1998</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Remaining Contractual Life</u>	<u>Number Exercisable at December 31, 1998</u>	<u>Weighted Average Exercise Price</u>
\$1.14-1.19	178,750	\$ 1.16	3.4	178,750	\$ 1.16
\$4.50-7.63	477,625	\$ 6.62	8.9	92,650	\$ 5.80
\$9.00-11.25	82,500	\$ 9.77	9.5	-	\$ -

The Company applies the disclosure-only provisions of SFAS No. 123, "Accounting for Stock-Based Compensation." Accordingly, no compensation cost has been recognized for the stock option plans. Had compensation cost for the Company's stock option plans been determined consistent with the provisions of SFAS No. 123, the Company's net income and earnings per share would have been reduced to the pro forma amounts indicated below:

	<u>1998</u>	<u>1997</u>	<u>1996</u>
Net income:			
As reported	\$ 5,230	\$ 3,022	\$ 2,075
Pro forma	\$ 4,949	\$ 2,872	\$ 2,004
Basic earnings per share:			
As reported	\$.84	\$.49	\$.34
Pro forma	\$.80	\$.47	\$.33
Diluted earnings per share:			
As reported	\$.82	\$.48	\$.33
Pro forma	\$.78	\$.46	\$.32

Because the SFAS No. 123 method of accounting has not been applied to options granted prior to January 1, 1995, the resulting pro forma compensation cost may not be representative of that to be expected in future years.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions: dividend yield of 0%; expected volatility of 42.46% to 50.79%; risk-free interest rate of 4.38% to 6.98%; and expected lives of four to eight years.

The Company sponsors a defined contribution benefit plan. Employees can make contributions at a minimum of 1% and a maximum of 15% of compensation. The Company may, on a discretionary basis, contribute a Company matching contribution not to exceed 6% of compensation. The Company made matching contributions of \$595, \$159 and \$97 in 1998, 1997 and 1996, respectively.

The Company maintains a profit sharing bonus plan under which 10% of pre-tax profit is paid to eligible employees on a quarterly basis. Profit sharing expense was \$902, \$509 and \$303 for the years ended December 31, 1998, 1997 and 1996, respectively.

LANCE ABENDROTH
TYRONE ABERCROMBIE
ANTONIO ACOSTA
CARLOS ACOSTA
MARTHA ACOSTA
GARY ADAMS
DALE ADKINSON
BEN ADKISON
STEPHEN ALCORN
WILLIE ALEXANDER
DONALD ALLEN
JONNIE ALLEN
KEVIN ALLEN
JOSEFINA ALMAGUER
ANGEL ALVARADO
CINDY ALVARADO
LUIS ALVARADO
LUCY ALVAREZ
MIREYA ALVAREZ
MICHAEL AMBURGEY
CYNTHIA AMENT
JIM AMENT
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